

# Investment Market Review Third Quarter 2016

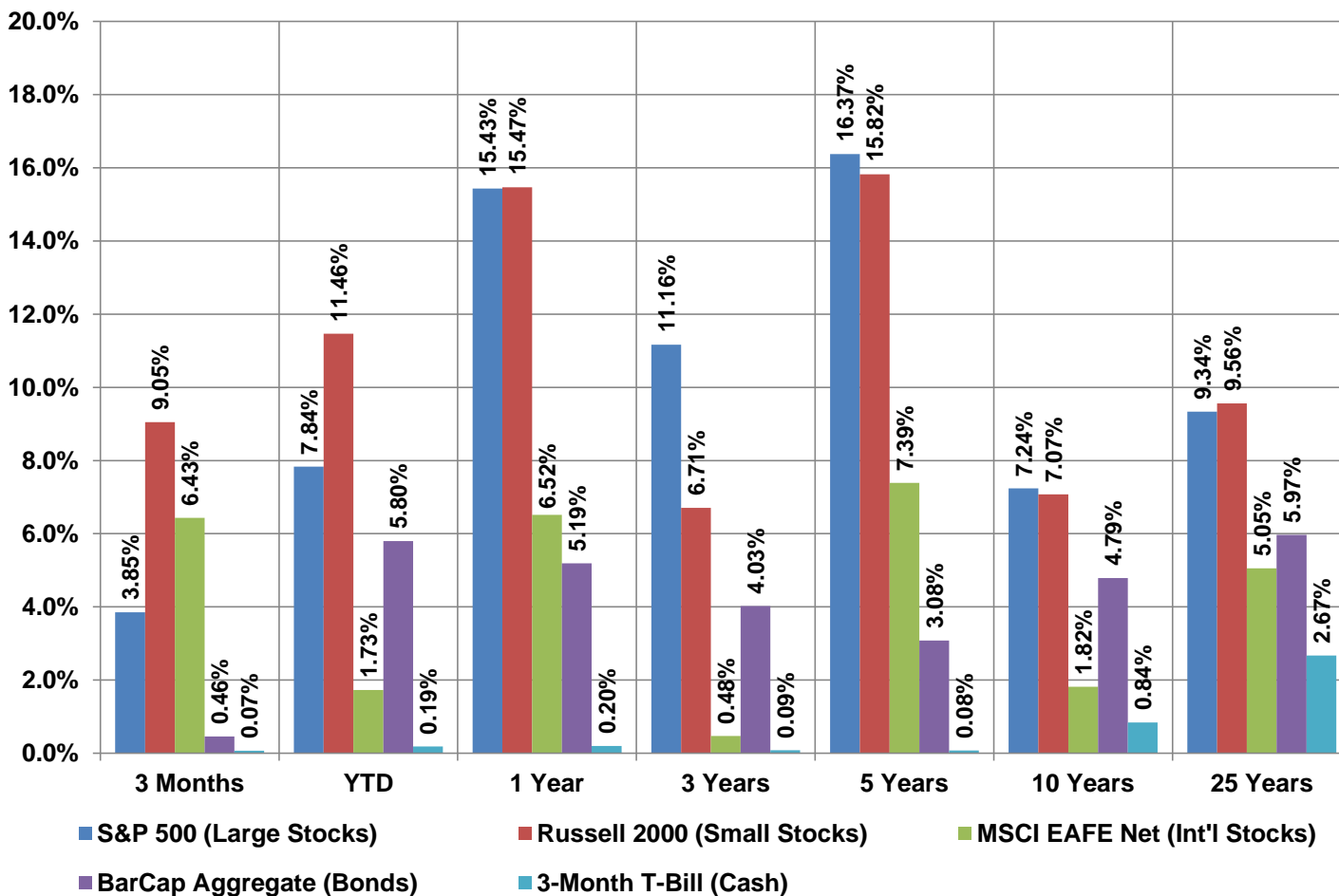
## State of Montana

# Capital Market Highlights

- U.S. stocks produced positive returns during the third quarter with the S&P 500 index returning +3.9%. Bonds were positive during the third quarter with the Barclay's Capital US Aggregate index up +0.5%.
- International developed market stocks were positive with the MSCI EAFE returning +6.4% for the quarter, reversing course from the -1.5% loss experienced during the second quarter. Returns on emerging markets stocks moved further into positive territory in the third quarter with the MSCI Emerging Markets index returning +9.0% and is up +16.0% year-to-date. Emerging markets debt continued to post strong positive returns into the third quarter with the JP Morgan Emerging Markets Bond index returning +3.7% and is up +15.0% year-to-date.
- Initial forecasts projected four rate hikes throughout 2016; however, mild economic data and tepid inflation now point to zero to one rate hike by the end of the year. A similar scenario played out in 2015 with multiple projected rate increases never materializing. Hourly wage growth improved to 3.6% in June and is at the highest level in nearly seven years, which may provide support for one rate hike by the end of 2016.
- The unemployment rate dropped to 4.7% in May, the lowest level in nine years, before increasing slightly to end the third quarter at 5.0%. The slight increase in the unemployment rate from August to September shows that more Americans may be entering the workforce as the economy improves and are now being reflected in the unemployment rate as they look for work.
- The labor force participation rate reached its lowest levels in nearly 40 years in September 2015, and has trended higher over the last year to end the third quarter at 62.9%. This number should continue to increase as workers re-enter the labor force due to a higher level of optimism in their job prospects and improved wage growth.
- Inflation finally reached 1% in the second quarter after hovering between 0% and 1% since 2014. The Fed is targeting 2%, but this level hasn't been reached since early 2014. Although wage growth looks better than it has in years, inflation remains a hurdle for rate increases.
- West Texas Intermediate (WTI) oil futures continue their volatility and ended the quarter at \$48.24, within pennies of the \$48.33 quarter opening price. The price dropped steadily throughout July to a low near \$40. OPEC has stood by a "pump at any price" strategy since 2014, but on September 28<sup>th</sup> agreed to limit production for the first time in eight years.

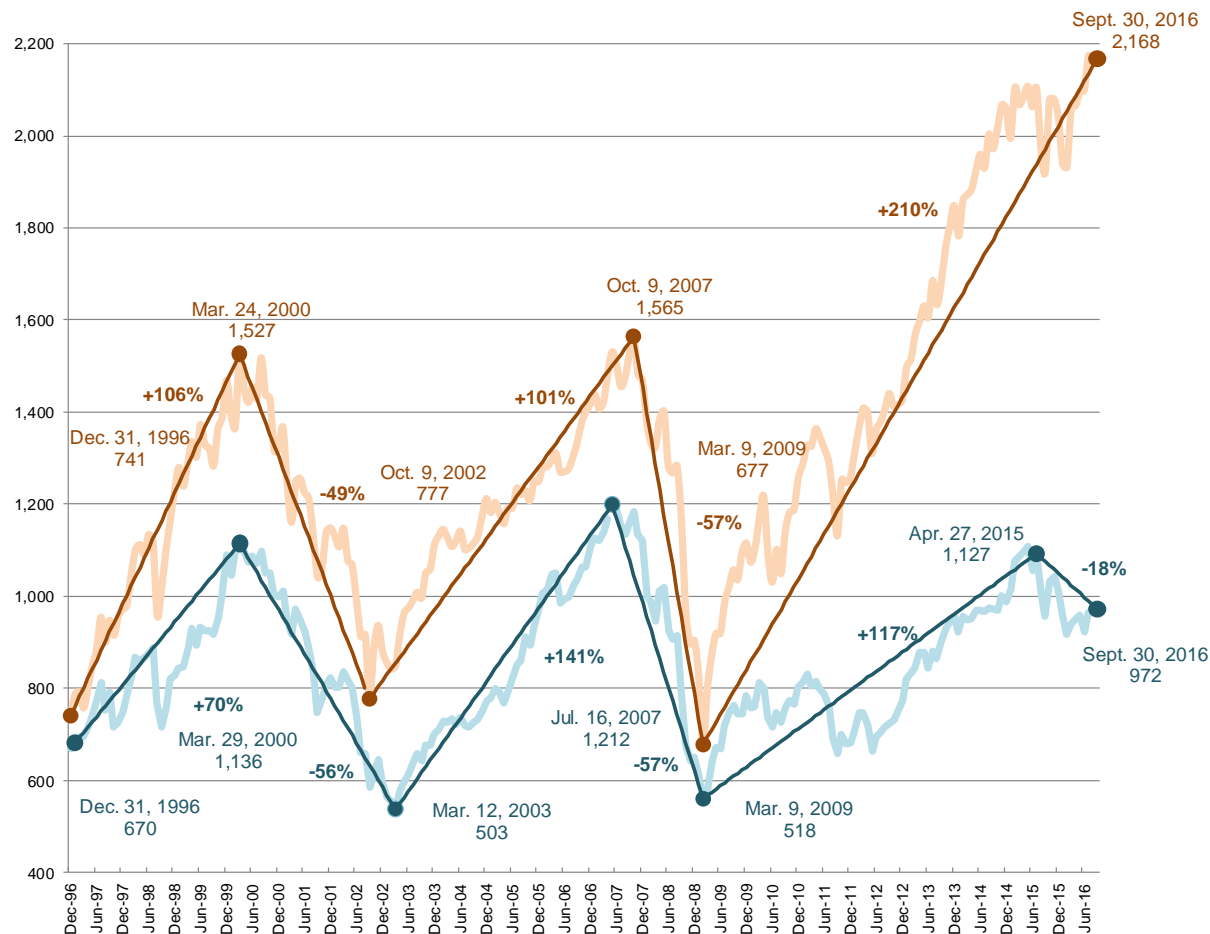
# Capital Market Highlights

Capital Market Performance as of September 30, 2016



# Capital Market Highlights

## S&P 500 and MSCI EAFE at Inflection Points



S&P 500	P/E (fwd)
Dec. 31, 1996	16.0
Mar. 24, 2000	25.6
Oct. 9, 2002	14.1
Oct. 9, 2007	15.2
Mar. 9, 2009	10.3
Sept. 30, 2016	16.8

MSCI EAFE	P/E (fwd)
Dec. 31, 1996	19.5
Mar. 29, 2000	28.7
Mar. 12, 2003	13.2
Jul. 16, 2007	14.5
Mar. 9, 2009	10.2
Apr. 27, 2015	18.1
Sept. 30, 2016	14.6

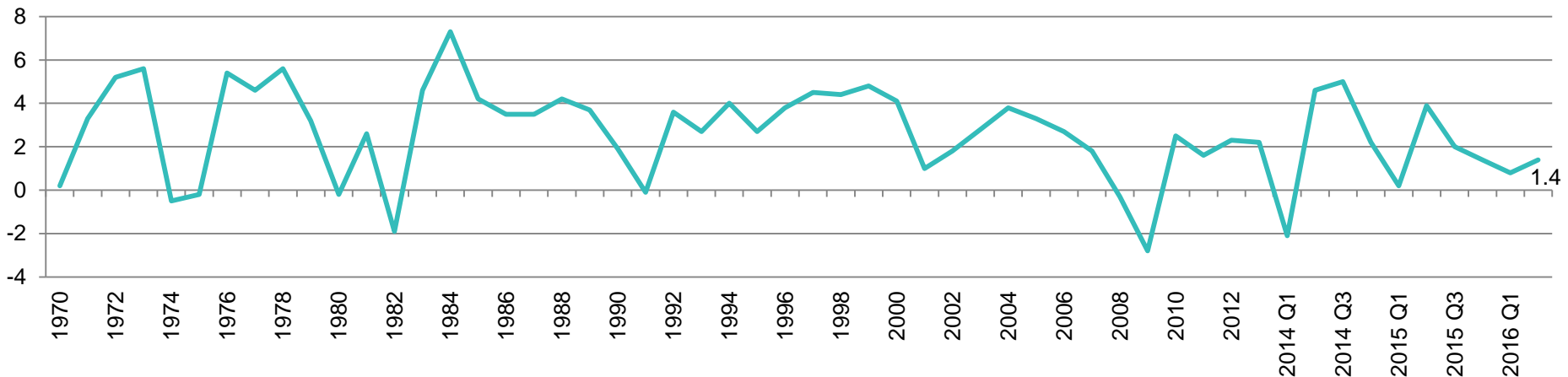
Source: Standard & Poor's,  
Morgan Stanley Capital International,  
J.P. Morgan Asset Management

Returns based on S&P 500 Index Price Movement and  
MSCI EAFE Local Currency Index Price Movement

# US Economy

- GDP growth has been slowing over the last year. Annualized GDP in the second quarter of 2016 was 1.4%, which is down from 3.9% in the second quarter of 2015. Personal consumption expenditures continue to be among the leading contributors to GDP with nonresidential fixed investment and exports also being among the largest contributors to second quarter GDP. State and local government spending, private inventory investment, and residential fixed investment were detractors during the quarter.
- GDP estimates in the first quarter were revised down to 0.8% from 1.1%. Previous forecasts for the second half of 2016 placed growth between 2% to 2.5%; however, it looks less likely that the 2% estimate will be achieved given the recent revisions. Third quarter estimates are 2.4%, but have been trending steadily lower over the quarter. Third quarter GDP numbers have not been released.

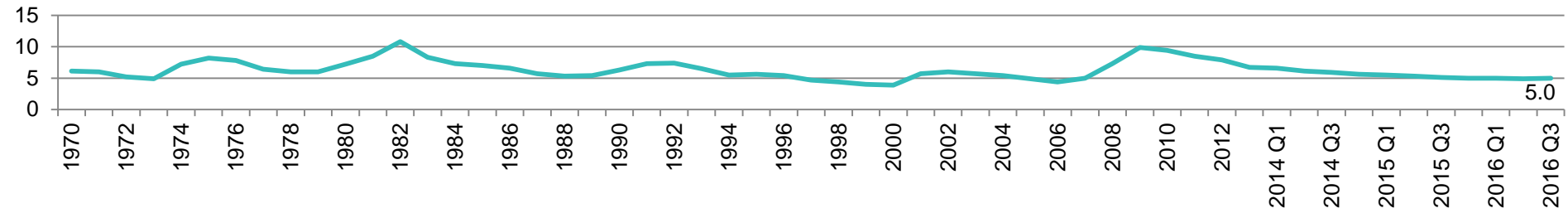
**Real GDP**



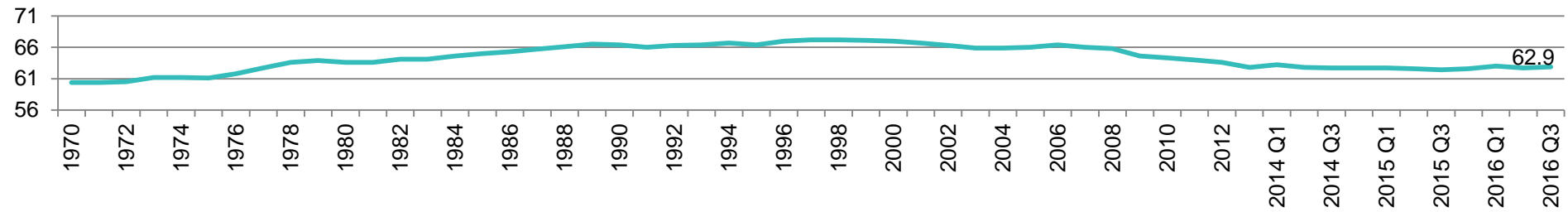
Source: BEA

# US Economy

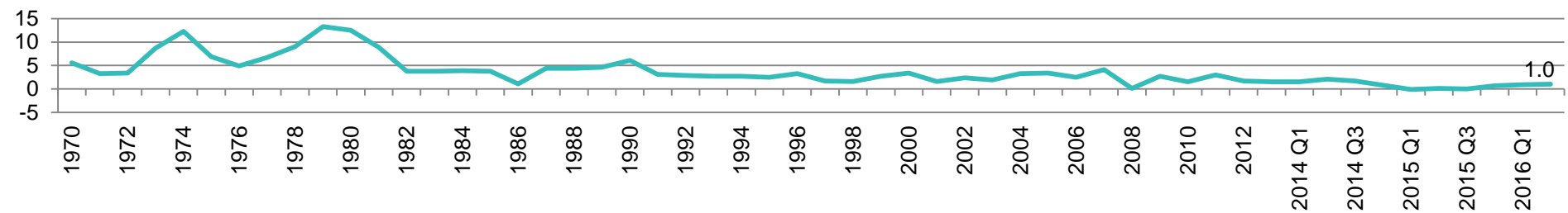
## Unemployment



## Labor Force Participation Rate



## Headline CPI

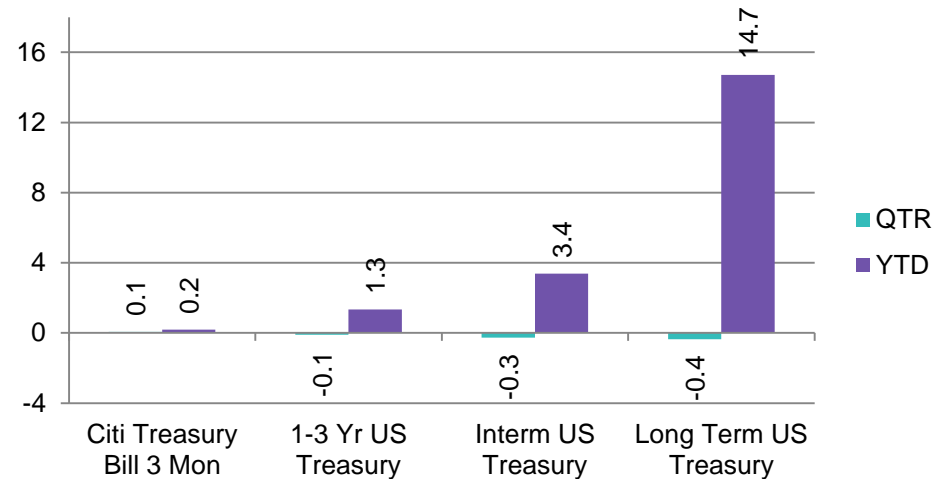


Source: BLS, St. Louis Federal Reserve

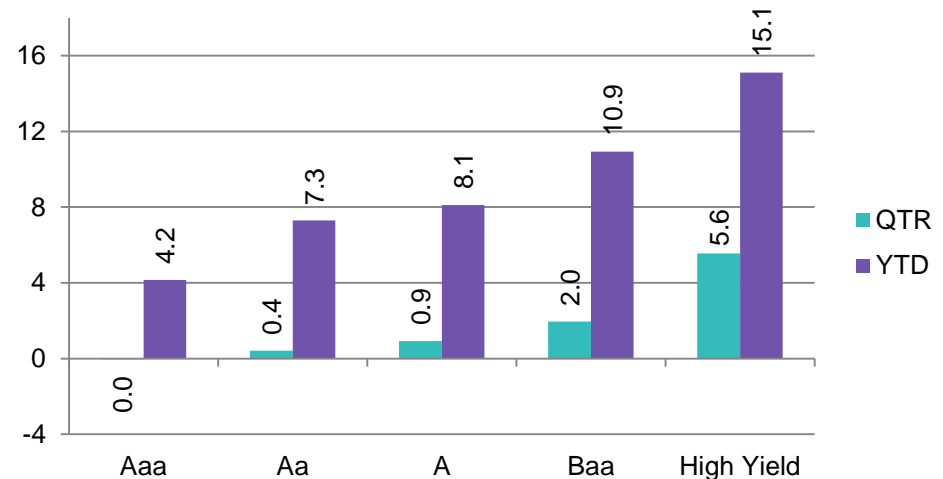
# Fixed Income

- **High Yield** struggled in 2015 but has bounced back strongly in 2016. High yield performed well in July and August, producing monthly returns between 2-3%. September came with a slow down, but returns remained positive in comparison to the negative returns from investment grade credit. For the quarter, high yield produced a positive return of +5.6%, outperforming the investment grade fixed income return of +1.4%.
- The yield on 10 Year Treasury Notes ticked up slightly over the third quarter, although with some volatility early in July following Brexit. During the quarter the low was 1.37% and the high was 1.73%. The yield on 10 Year Treasury Notes began the quarter at 1.49% and ended at 1.61%.

## Bond Performance by Maturity



## Bond Performance by Quality

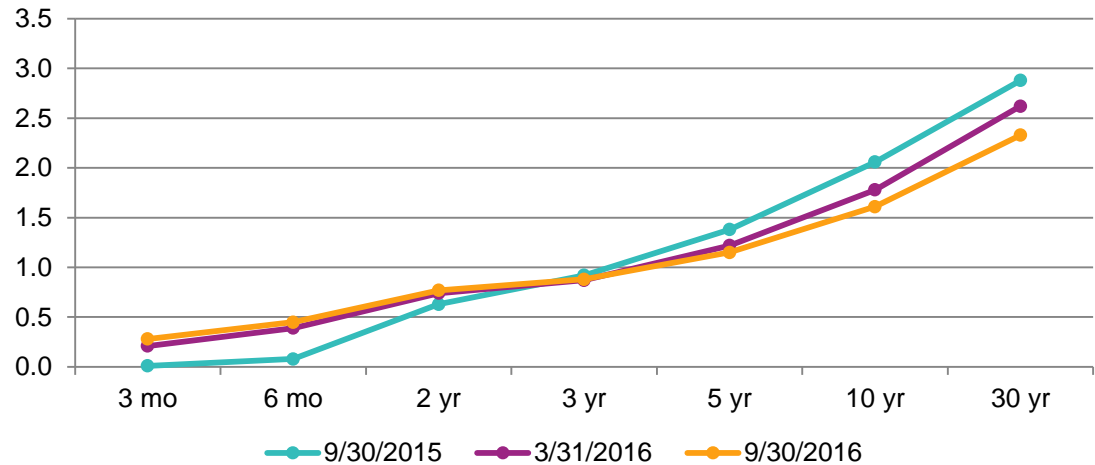


Source: Morningstar, Barclays Capital US Credit Indices

# Fixed Income

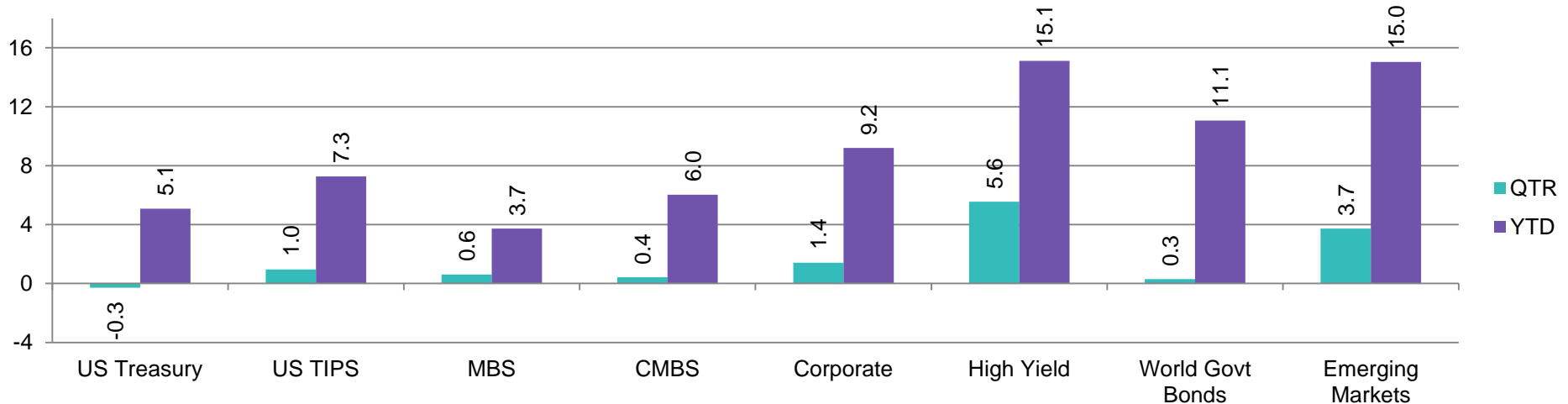
- The **Barclays Aggregate Index** returned +0.5% for the quarter.
- **Long Gov/Credit** and **Long Treasuries** returned +1.2% and -0.4% for the quarter, respectively. Long Gov/Credit is up +15.7% YTD and Long Treasuries are up +14.7% YTD.

## US Treasury Yield Curve



Source: Barclays

## Bond Performance by Sectors



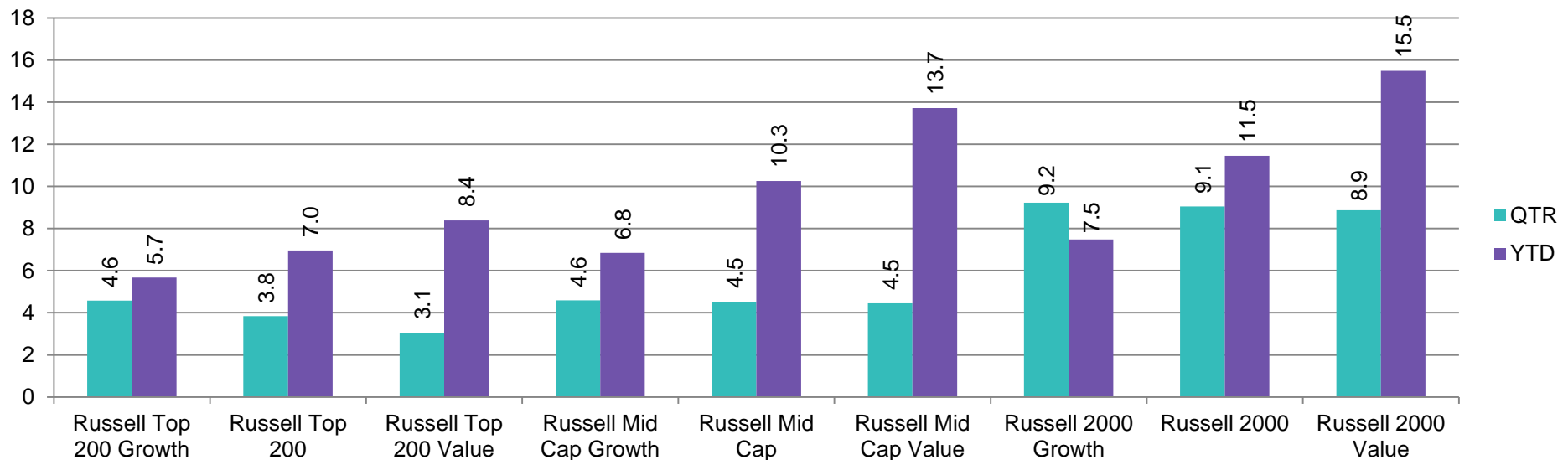
Source: Morningstar



# Equities

- US Equities were up for the quarter, with the **S&P 500** returning +3.9%.
- In terms of market capitalization, small cap stocks (**Russell 2000**) continued to be the best performing, returning +9.1% for the quarter. In comparison, large- and mid-cap returned +3.8% and +4.5%, respectively, as measured by the **Russell Top 200** and the **Russell Mid Cap**. In contrast to the second quarter, growth stocks in all market caps outperformed value stocks.
- Performance continued to accelerate in the third quarter after a slightly positive first quarter and a strong second quarter. All market caps produced robust July returns before trading closer to 0% for August and September. Small cap stocks were the exception and generated positive returns in each month. The Dow delivered a return of +4.4% during the third quarter, with 90% of the returns coming in July.

**US Stocks by Capitalization/Style**

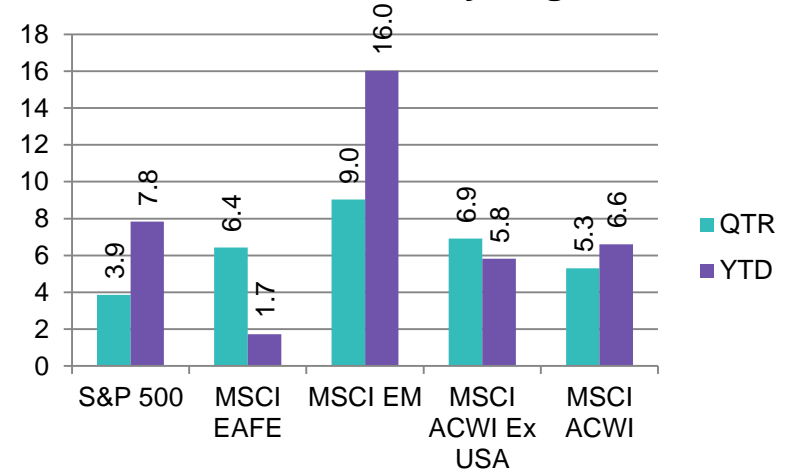


Source: Morningstar

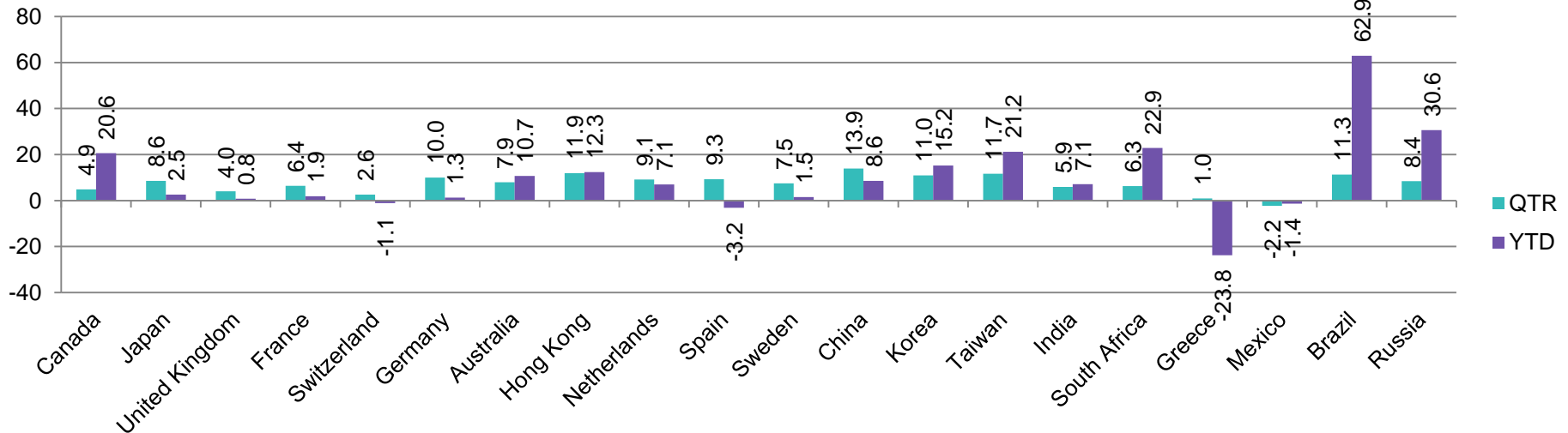
# Equities

- **International Equities** were positive over the quarter with developed market equities returning +6.4%. German equities gained +10.0%, French equities gained +6.3%, and Switzerland was up +2.6%. The United Kingdom was up +4.0%. After a difficult first quarter and minimal growth in the second quarter, Japan was able to produce a positive +8.6% return for the third quarter.
- **Emerging Market Equities** had a strong quarter returning +9.0%. China returned +13.9%, South Korea was up +11.0%, Taiwan was up +11.7%, and India was up +5.9%.

## Global Stocks by Region



## Global Stocks by Country



Source: Morningstar

# Market Indices

## For Periods Ended September 30, 2016

Index	3 Months Return	6 Months Return	9 Months Return	1 Year Return	2 Years Return	3 Years Return	4 Years Return	5 Years Return	10 Years Return
S&P 500 Index	3.85	6.40	7.84	15.43	7.11	11.16	13.15	16.37	7.24
Russell 1000 Index	4.03	6.67	7.92	14.93	6.88	10.78	13.23	16.41	7.40
Russell Midcap Index	4.52	7.84	10.26	14.25	6.76	9.70	13.99	16.67	8.32
Russell 2000 Index	9.05	13.18	11.46	15.47	8.12	6.71	12.12	15.82	7.07
Russell 3000 Index	4.40	7.14	8.18	14.96	6.96	10.44	13.13	16.36	7.37
Russell 1000 Growth Index	4.58	5.22	6.00	13.76	8.34	11.83	13.64	16.60	8.85
Russell 1000 Value Index	3.48	8.22	10.00	16.20	5.38	9.70	12.73	16.15	5.85
Russell Midcap Growth Index	4.59	6.23	6.84	11.24	6.23	8.90	13.29	15.85	8.51
Russell Midcap Value Index	4.45	9.43	13.72	17.26	7.16	10.49	14.58	17.38	7.89
Russell 2000 Growth Index	9.22	12.76	7.48	12.12	8.01	6.58	12.66	16.15	8.29
Russell 2000 Value Index	8.87	13.55	15.49	18.81	8.12	6.77	11.51	15.45	5.78
MSCI EAFE Index	6.43	4.88	1.73	6.52	-1.36	0.48	5.85	7.39	1.82
MSCI Emerging Markets Index	9.03	9.75	16.02	16.78	-2.91	-0.56	-0.18	3.03	3.95
MSCI All Country World ex USA	6.91	6.22	5.82	9.26	-2.04	0.18	4.03	6.04	2.16
NAREIT Equity REITs	-1.43	5.42	11.75	19.86	14.76	14.22	12.07	15.91	6.35
Barclays Capital Aggregate Bond Index	0.46	2.68	5.80	5.19	4.06	4.03	2.57	3.08	4.79
Barclays Capital Intermediate G/C Bond Index	0.16	1.75	4.24	3.52	3.10	2.80	1.96	2.45	4.17
Barclays Capital Long Term G/C Bond Index	1.24	7.87	15.74	14.66	8.72	10.08	5.16	6.32	7.84
Barclays Capital U.S. TIPS	0.96	2.69	7.27	6.58	2.81	2.40	0.21	1.93	4.48
Barclays Capital U.S. Government	-0.25	1.78	4.96	4.00	3.84	3.32	1.97	2.16	4.34
Barclays Capital U.S. Corporate Inv Grade	1.41	5.03	9.20	8.56	5.06	5.63	3.78	5.14	5.91
Barclays Capital U.S. Corporate High Yield	5.55	11.38	15.11	12.73	4.34	5.28	5.74	8.34	7.71
Citigroup Non-US WGBI USD	0.60	4.66	14.18	12.61	2.33	1.21	-0.55	0.24	3.94
JP Morgan EMBI Global Diversified USD	4.04	9.26	14.77	16.20	7.46	8.19	4.99	7.75	7.73
JP Morgan GBI EM Global Diversified USD	2.68	5.46	17.07	17.06	-3.09	-2.58	-2.87	0.06	5.52
Citigroup 90-Day Treasury Bills	0.07	0.13	0.19	0.20	0.11	0.09	0.08	0.08	0.84

Note: Returns greater than one year are annualized.

# Market Indices

## Annual Returns

Index	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
S&P 500 Index	1.38	13.69	32.39	16.00	2.11	15.06	26.46	-37.00	5.49	15.79
Russell 1000 Index	0.92	13.24	33.11	16.42	1.50	16.10	28.43	-37.60	5.77	15.46
Russell Midcap Index	-2.44	13.22	34.76	17.28	-1.55	25.48	40.48	-41.46	5.60	15.26
Russell 2000 Index	-4.41	4.89	38.82	16.35	-4.18	26.85	27.17	-33.79	-1.57	18.37
Russell 3000 Index	0.48	12.56	33.55	16.42	1.03	16.93	28.34	-37.31	5.14	15.72
Russell 1000 Growth Index	5.67	13.05	33.48	15.26	2.64	16.71	37.21	-38.44	11.81	9.07
Russell 1000 Value Index	-3.83	13.45	32.53	17.51	0.39	15.51	19.69	-36.85	-0.17	22.25
Russell Midcap Growth Index	-0.20	11.90	35.74	15.81	-1.65	26.38	46.29	-44.32	11.43	10.66
Russell Midcap Value Index	-4.78	14.75	33.46	18.51	-1.38	24.75	34.21	-38.44	-1.42	20.22
Russell 2000 Growth Index	-1.38	5.60	43.30	14.59	-2.91	29.09	34.47	-38.54	7.05	13.35
Russell 2000 Value Index	-7.47	4.22	34.52	18.05	-5.50	24.50	20.58	-28.92	-9.78	23.48
MSCI EAFE Index	-0.81	-4.90	22.78	17.32	-12.14	7.75	31.78	-43.38	11.17	26.34
MSCI Emerging Markets Index	-14.92	-2.19	-2.60	18.22	-18.42	18.88	78.51	-53.33	39.42	32.14
MSCI All Country World ex USA	-5.66	-3.87	15.29	16.83	-13.71	11.15	41.45	-45.53	16.65	26.65
NAREIT Equity REITs	3.20	30.14	2.47	18.06	8.29	27.96	27.99	-37.73	-15.69	35.06
Barclays Capital Aggregate Bond Index	0.55	5.97	-2.02	4.21	7.84	6.54	5.93	5.24	6.97	4.33
Barclays Capital Intermediate G/C Bond Index	1.07	3.13	-0.86	3.89	5.80	5.89	5.24	5.08	7.39	4.08
Barclays Capital Long Term G/C Bond Index	-3.30	19.31	-8.83	8.78	22.49	10.16	1.92	8.44	6.60	2.71
Barclays Capital U.S. TIPS	-1.44	3.64	-8.61	6.98	13.56	6.31	11.41	-2.35	11.64	0.41
Barclays Capital U.S. Government	0.86	4.92	-2.60	2.02	9.02	5.52	-2.20	12.39	8.66	3.48
Barclays Capital U.S. Corporate Inv Grade	-0.68	7.46	-1.53	9.82	8.15	9.00	18.68	-4.94	4.56	4.30
Barclays Capital U.S. Corporate High Yield	-4.47	2.45	7.44	15.81	4.98	15.12	58.21	-26.16	1.87	11.85
Citigroup Non-US WGBI USD	-5.54	-2.68	-4.56	1.51	5.17	5.21	4.39	10.11	11.45	6.94
JP Morgan EMBI Global Diversified USD	1.18	7.43	-5.25	17.44	7.35	12.24	29.82	-12.03	6.16	9.86
JP Morgan GBI EM Global Diversified USD	-14.92	-5.72	-8.98	16.76	-1.75	15.68	21.98	-5.22	18.11	15.22
Citigroup 90-Day Treasury Bills	0.03	0.03	0.05	0.07	0.08	0.13	0.16	1.80	4.74	4.76